

**Exhibit No.:**

**Issue(s):**

**Witness/Type of Exhibit:**

**Sponsoring Party:**

**Case No.:**

\_\_\_\_\_  
Affiliate Transaction

Schallenberg/Direct

Public Counsel

ER-2019-0374

**DIRECT TESTIMONY**

**OF**

**ROBERT E. SCHALLENBERG**

Submitted on Behalf of the Office of the Public Counsel

**EMPIRE DISTRICT ELECTRIC COMPANY**

CASE NO. ER-2019-0374

April 13, 2020



**DIRECT TESTIMONY**

**OF**

**ROBERT E. SCHALLENBERG**

**THE EMPIRE DISTRICT ELECTRIC COMPANY (EDE)**

**FILE NO. ER-2019-0374**

1 **Q. What is your name, title and business address?**

2 A. My name is Robert E. Schallenberg. I am the Director of Policy at the Office of Public Counsel.  
3 My business address is the Governor Office Building, Suite 650, 200 Madison Street, Post Office  
4 Box 2230, Jefferson City, Missouri 65102.

5 **Q. What is your educational background and work experience?**

6 A. Please see the attached RES-D-1 with details on my education, professional certifications and work  
7 experience.

8 **Q. What is the purpose of your testimony?**

9 A. The purpose of my direct testimony is to examine issues with Empire District Electric (EDE or  
10 Company) regarding the affiliate transactions costs the Company records on its books and  
11 accounts. I have recommendations as to how the EDE's affiliate transactions should be addressed  
12 in this case. I will identify non-compliant affiliate transactions<sup>1</sup> and discuss the implications of  
13 EDE recording non-compliant affiliate transactions on its books and records for rate recovery in  
14 this rate case. The Public Service Commission's (MoPSC or Commission) "Presumption of  
15 Prudence" practice has been found by the Missouri Supreme Court to be inappropriate if applied  
16 to the utility's affiliate transactions. EDE has the affirmative burden to prove the legitimacy and  
17 prudence of its affiliate transaction purchases and sales.<sup>2</sup>

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<sup>1</sup> The Commission's current Electric Affiliate Transactions rules are found at 20 CSR 4240-20.015.

<sup>2</sup> Counsel has provided a copy of *Office of the Public Counsel v Mo.PSC 409 S.W.3d 371* (Mo. 2013) which is attached.

1 **Q. What experience do you have with utility affiliate transactions?**

2 A. I was involved in developing the affiliate transaction rule's content. I was also involved in the rate  
3 cases that caused the Commission to promulgate an affiliate transactions rule to support the  
4 identification and treatment of affiliate transaction issues in rate cases. The rules are designed to  
5 address the provision or sale of goods and services to any affiliate, regulated or unregulated. The  
6 rules are designed to address the issue of transactions between Missouri electric utility companies  
7 that are owned by non-regulated entities and Missouri electric utilities and to prevent regulated  
8 utilities from subsidizing their other regulated entities and their non-regulated operations.

9 **Q. Was there a particular goal that was the primary reason the Commission adopted its rules?**

10 A. Yes. The rule was designed to address the issue caused by affiliate transactions in rate cases. It is  
11 intended to protect utility customers from subsidizing a utility's affiliated entities, and to facilitate  
12 auditing of rate cases to identify the amount of affiliated transaction costs on utility companies'  
13 books and records used to establish customer rates.

14 **Q. Why is distinguishing between arms-length transactions and affiliate transactions  
15 important?**

16 A. The affiliate transaction is an inferior business transaction because it is between related entities.  
17 Normally a business transaction occurs as a result of the actions of independent and non-conflicted  
18 buyers and sellers. This type of transaction is commonly referred to as an arms-length transaction  
19 where the buyer or seller can walk away from a transaction whenever they feel they have better  
20 opportunities elsewhere. Affiliate transactions are transactions between non-independent and  
21 conflicted buyers and sellers where the parties are influenced by the common control factor  
22 preventing the buyer and seller from pursuing the best interest of the party they represent.

1 **Q. Has EDE complied with the affiliate transactions rule 20 CSR 4240 -20.015?**

2 A. No.

3 **Q. What is Schedule RES-D-2?**

4 A. This schedule is a copy of the Commission's affiliate transactions rule for electric utilities. The  
5 purpose of the schedule is provide a reference source since the rule is frequently referenced in this  
6 testimony.

7 **Q. What is Schedule RES-D-3?**

8 A. This schedule contains the two Missouri Supreme Court opinions addressing the legitimacy and  
9 proper application of the rule. This testimony will reference the Court's decisions that address the  
10 rule's legitimacy and application.

11 **Q. What is Schedule RES-D-4?**

12 A. This schedule contains findings of the Commission in support of its current rules as published in  
13 the Missouri Register Vol. 25, No. 1, p. 55 Jan. 3, 2000, and the second part of this schedule  
14 contains quotations from the Commission's brief to the Missouri Supreme Court supporting the  
15 rule, providing insight into the rule purpose and objectives.

16 **Q. How long has EDE failed to comply with the MoPSC's affiliate transactions rules?**

17 A. I have not known a time period where EDE has complied with the Commission's rule. The nature  
18 and scope of EDE's affiliate transactions, however, changed dramatically with the Algonquin  
19 acquisition of EDE and its subsidiaries in 2017.

20 **Q. Is the level of EDE's non-compliance significant?**

21 A. Yes. EDE's level of non-compliance is significant, and affects all of its affiliate transactions. Since  
22 EDE does not have any employees, affiliates incur most of the costs and provide all goods and

1 services needed to provide safe and adequate service at just and reasonable rates to EDE's Missouri  
2 retail electric customers. EDE participates in non-compliant affiliate transactions that are  
3 prohibited by the Standards requirements established in the Missouri Commission's Affiliate  
4 Transactions Rule (the rule) that states:

5 (D) The regulated electrical corporation shall not participate in any affiliated  
6 transactions which are not in compliance with this rule, except as otherwise provided  
7 in section (10) of this rule. See 20 CSR 4240-20.015(2)(D).  
8

9 By participating in non-complying affiliate transaction, the Missouri utility is subsidizing the  
10 affiliate. The rule was designed so that the utilities will treat their affiliates in the same manner as  
11 non-affiliates. The rule's Standards section is one of ten (10) sections of the rule. The Standards  
12 are in section (2). The other sections are (1) Definitions, (3) Evidentiary Standards, (4) Record  
13 Keeping Requirements, (5) Records of Affiliated Entities, (6) Access to Records of Affiliated  
14 Entities, (7) Record Retention, (8) Enforcement, (9) training, and (10) Variances.

15 **Q. What is the nature of EDE's non-compliance?**

16 A. First, EDE operates under two (2) different cost allocation manuals (CAM). EDE does a majority  
17 of its affiliate transactions, approximately \$100 million worth in 2018, under the Algonquin Power  
18 & Utilities Corp. CAM (Algonquin CAM). When EDE is doing business with its subsidiaries, such  
19 affiliate transactions are performed under what is referred to as the Missouri CAM (Mo CAM).  
20 The MoPSC has not approved either of these CAMs.

21 **Q. What was EDE's corporate structure before Algonquin acquired it?**

22 A. EDE was a fully functioning electric and water utility, holding company, and service company to  
23 its subsidiaries, Empire District Gas (EDG) and Empire District Industries (EDI), with cost so fair  
24 market price information was already available. The acquisition placed EDE in the best situation

1 operationally to determine whether its new affiliate transactions were compliant with the rule. To  
2 comply with the affiliate transactions rule and protect its customers, EDE needed to compare these  
3 new allocations to its current fully distributed costs to provide these good and services to itself. If  
4 the allocated costs increased the costs for the goods and services, then EDE was prohibited by the  
5 rule from participating in the transaction. EDE produced no documentation that any such  
6 compliance documentation exists.

7 **Q. Did EDE execute any affiliate contracts stating the affiliates must fully conform to the**  
8 **Commission's rule after the Algonquin acquisition?**

9 A. No.

10 **Q. Did EDE execute any affiliate contracts indicating the Company will conform to APUC's**  
11 **CAM?**

12 A. Yes. These contracts were effective on June 30, 2017.

13 **Q. When was EDE acquired by Algonquin?**

14 A. January 1, 2017.

15 **Q. When were EDE's employees transferred to Liberty Utilities Service Corp. (LUSC)?**

16 A. May 1, 2017.

17 **Q. How has Empire's level of non-compliance with the Commission's rule changed after**  
18 **Algonquin acquired EDE?**

19 A. It has increased as the scope and scale of EDE's affiliate transactions have expanded.

20 **Q. What changes have happened since Algonquin acquired EDE that are consequential to**  
21 **Missouri ratepayers?**

1 A. Now, after the acquisition, EDE has no (0) employees and is operated by a non-regulated services  
2 company, which has unfettered use of EDE's regulated assets. EDE did not request or receive this  
3 Commission's approval for this type of transformation of the Company. It did file a merger case,  
4 Case No. EM-2016-0213, which resulted in numerous Stipulations and Agreements. But, the non-  
5 company parties to that case did not anticipate that in this new organization under Algonquin's  
6 control, EDE would have no employees and a non-regulated affiliate would be using its regulated  
7 assets. Neither Missouri statute nor the affiliate transactions rule prevented this Company  
8 reorganization to occur without a showing that these changes would have no detrimental impact  
9 to the public interest. These transactions were not included in EDE's 2017 Affiliate Transaction  
10 Report submitted to the Commission, nor did EDE report the absence of a contract for these  
11 affiliate transactions.

12 **Q. How is EDE charged for affiliate transactions?**

13 A. EDE receives allocated cost assignments primarily from Liberty Utility Services Company  
14 (LUSC) based on factors that are wholly unrelated to the goods and services EDE uses or the  
15 amount of goods or services EDE uses. In contrast, the affiliate transactions rules require the cost  
16 to be included in rates be based on cost of the goods and services EDE uses.

17 Because EDE did not competitively bid the goods or services it used to serve its customers, or  
18 demonstrate that competitive bidding was neither necessary nor appropriate for these affiliate  
19 transactions, it has no ability to determine fair market price (FMP), or the fully distributed cost  
20 (FDC) for it to produce the good or service for itself.

21 **Q. Can you give other examples of Algonquin's treatment of affiliate transactions?**

1 A. Yes. EDE has no control of its affiliate transaction costs. EDE is charged “pooled” costs that are  
2 allocated based on factors independent of the actual value of the goods and services EDE needs or  
3 receives. Affiliate charges to EDE give no consideration to the fact that the affiliate charge cannot  
4 be greater than the fair market price or its fully distributed cost to EDE to provide the goods and  
5 services to itself. EDE is prohibited from selling its goods or services for less than the product’s  
6 FMP (i.e. what would it cost the affiliate to purchase the product elsewhere) or fully distributed  
7 cost (FDC) for any goods or services EDE could produce for itself.

8 **Q. How are the pooled costs allocated to EDE?**

9 A. Pooled costs are allocated to EDE based on the application of one of two (2) CAMs. EDE operates  
10 under two (2) Cost Allocation Manuals (CAM) neither of which this Commission approved. One  
11 of the CAMs is called the APUC CAM, and its use is specifically included in EDE’s contract with  
12 its largest affiliate suppliers. Schedule RES-D-5 is the Company responses in Case No. AO-2018-  
13 0179 to a data request related to the characteristics of EDE’s affiliates such as the relationship  
14 between the Algonquin CAM and affiliate contracts, and its for-profit entity, LUCo.

15 **Q. What is EDE’s corporate relationship to Algonquin?**

16 A. Algonquin is not a direct owner of EDE. There are six (6) corporate owners between EDE and the  
17 ultimate owner, Algonquin. I have included as RES-D-6 a copy of EDE’s 2018 Affiliate  
18 Transaction Report. This schedule shows that the multiple owners between Algonquin and EDE  
19 are: EDE’s immediate owner Liberty Utilities (Central) Co., which is owned by Liberty Utilities  
20 Co, which is owned by Liberty Utilities (America) Holdco Inc., which is owned by Liberty Utilities  
21 (America) Holdings, LLC, that is owned by Liberty Utilities (America) Co., that is owned by

1 Liberty Utilities (Canada) Corp., who is finally owned by Algonquin Power & Utilities Corp. a  
2 Canadian corporation.

3 **Q. Which affiliates do business with EDE?**

4 A. Schedule RES-D-6 page 1 identifies eight (8) affiliates doing business with EDE in 2018. These  
5 eight affiliates are: 1) Empire District Industries, Inc. (EDI), 2)The Empire District Gas Company  
6 (EDG), 3) Algonquin Power & Utilities Corp. (APUC), 4) Liberty Utilities (Canada) Corp. (LUC),  
7 5) Liberty Utilities Service (LUSC), 6) Algonquin Power Co. d/b/a Liberty Power (APCO), 7)  
8 Liberty Utilities Co., and 8) Liberty Utilities (Park Water) Corp.

9 **Q. Which of these affiliates charged EDE and how much did they charge in 2018?**

10 A. In its 2018 Affiliated Transaction Report, EDE reported that it was charged \$99,083,774.94 under  
11 the APUC CAM, with the highest charges being \$79,201,970.16 (80%) coming from Liberty  
12 Utility Services (LUSC) , Liberty Utilities (Canada) Corp. (LUC) charged \$14,601,136.71 (15%)  
13 and Algonquin Power & Utilities Corp. (APUC) charged \$5,073,054.79 (5%).

14 **Q. Did any of these affiliates report their transactions to the Federal Energy Regulatory  
15 Commission (FERC) in 2018?**

16 A. Yes. APUC, LUSC, and LUC filed a FERC Form 60, Annual Report of Centralized Service  
17 Companies. Schedule RES-D-7 through Schedule RES-D-9 are the 2018 FERC Financial Reports  
18 for APUC, LUC, and LUSC respectively. In these Reports, on schedule XVII, page 307, APUC  
19 reports it charged EDE \$5,024,059 in 2018, the most charged to any Algonquin affiliate. The  
20 FERC LUC Financial Report showed on schedule XVII that LUC charged EDE \$20,364,018 in  
21 2018, the most charged to any Algonquin affiliate. On schedule XVII of the LUC FERC Financial

1 Report, it shows that LUSC charged EDE \$12,783,683 in 2018, the 4<sup>th</sup> highest charged to any  
2 Algonquin affiliate. .

3 **Q. Do the amounts on the Form 60 information coincide with the amounts on EDE's Affiliate**  
4 **Transaction Report to this Commission?**

5 A. No, the FERC Form 60 data shows different amounts being charged to EDE than what EDE reports  
6 it has been charged in the 2018 Affiliate Transaction Report.

7 **Q. Are any of these EDE affiliate transactions compliant with the Stipulation and Agreement(s)**  
8 **EDE and others signed in the merger case, Case No. EM-2016-0213?**

9 A. No. They are not. Not only are EDE's transactions a violation of the Commission's affiliate  
10 transaction rule, they are also a violation of the Algonquin acquisitions conditions requiring EDE  
11 to follow the rule. In Case No. EM-2016-0213, Empire and Algonquin committed to the following  
12 provisions acknowledging their legal obligation to operate in compliance with the MoPSC's  
13 affiliate transaction rule. In the Appendix to Attachment A-Staff Stipulation and Agreement,  
14 Section E lists three (3) conditions important to the OPC joining in that stipulation:

15 E. AFFILIATE TRANSACTIONS AND COST ALLOCATION MANUAL (CAM)

- 16
- 17 1. Empire is to be operated after the purchase in compliance with the affiliate transaction rule, or  
18 will obtain any necessary variances from the MoPSC's affiliate transaction rule as defined in 4  
19 CSR 240-20-015(10) and 4 CSR 240-40-015(10).
  - 20
  - 21 2. Algonquin Power & Utilities Corp. and its subsidiaries will commit that all information related  
22 to an affiliate transaction consistent with 4 CSR 240-20.015(5)(A)(1)-(2) and 4 CSR 240-  
23 40.015(5)(A)(1)-(2) charged to Empire will be treated in the same manner as if that information  
24 is under the control of Empire, and
  - 25
  - 26 3. Empire will provide no preferential service, information, or treatment to an affiliated entity over  
27 another party at any other time, consistent with 4 CSR 240-20.015(2) and 4 CSR 240-40.015(2).

1 **Q. Have any of these conditions been respected and satisfied?**

2 A. No. As noted in this testimony, EDE has not complied with the rule. They have not competitively  
3 bid these transaction nor applied costing methods on a goods and services basis.

4 **Q. Is there another merger condition that Algonquin has ignored to the detriment of Missouri**  
5 **consumers?**

6 A. Yes. The FINANCING CONDITIONS portion of the same Stipulation and Agreement approved  
7 by the Commission in EM-2016-0213 contained another condition. This condition contained the  
8 following language:

9 “6. The Joint Applicants will not obtain Empire financing services from an affiliate, unless such  
10 services comply with Missouri’s Affiliate Transaction Rules.”

11  
12 **Q. What parts of the Commission’s affiliate rules have Algonquin and EDE ignored?**

13 A. Algonquin, LUSC, LUCo, LUC, and EDE ignored the standards section of the rule prohibiting  
14 EDE from providing a financial advantage to an affiliate. In this case, EDE through its operation  
15 by LUSC provided and continues to provide a financial advantage to LUCo, one of its indirect  
16 owners. By providing and continuing to provide a financial advantage to LUCo, EDE is ignoring  
17 one of the rule’s Standards. The rule requirements, when satisfied, address the concern of  
18 subsidization from the utility’s perspective. The following rules include the prohibition against  
19 providing a financial advantage:

20 (2) Standards.

21 (A) A regulated electrical corporation shall not provide a financial advantage to an affiliated entity.  
22 For the purposes of this rule, a regulated electrical corporation shall be deemed to provide a  
23 financial advantage to an affiliated entity if—

24 1. It compensates an affiliated entity for goods or services above the lesser of—

25 A. The fair market price; or

- 1 B. The fully distributed cost to the regulated electrical corporation to provide the  
2 goods or services for itself; or  
3 2. It transfers information, assets, goods or services of any kind to an affiliated entity below  
4 the greater of—  
5 A. The fair market price; or  
6 B. The fully distributed cost to the regulated electrical corporation.  
7 20 CSR 4240-20.015(2)(A).  
8

9 This requirement basically prohibits a utility from subsidizing its affiliate or the utility's non-  
10 regulated activities by paying either more than it would cost the utility to do the activity itself or  
11 what it would pay to an independent third party vendor.

12 **Q. What are the specifics of what EDE, through its operator LUSC, did and continues to do to**  
13 **provide a financial advantage to one of its indirect owners, LUCo?**

14 A. EDE allowed its affiliates, LUSC and LUCo. to provide EDE with the financial services to redeem  
15 EDE's \$90 million first mortgage bonds that were due on June 1, 2018. The actual transaction  
16 that took place was that LUCo borrowed \$90 million from its \$500 million line of credit or credit  
17 facility to redeem the bonds. In essence, LUCo used short-term debt financing to replace EDE's  
18 long term debt. EDE had the capability to execute LUCo's short-term debt financing on better  
19 terms than LUCo since EDE had the capability to get commercial financing with a lower interest  
20 cost, which was not available to LUCo and its credit facility at this time.

21 **Q. Why would LUSC and LUCo not allow EDE to use its lower cost commercial paper short**  
22 **term debt capability to refinance the \$90 million first mortgage bonds, when it would reduce**  
23 **the interest costs to EDE and Algonquin consolidated?**

24 A. LUCo., under LUSC's control, could not have realized any profit from EDE's customers if the  
25 least cost option had been utilized.

1 **Q. How did LUCo and LUSC profit at EDE's customers' expense?**

2 A. LUSC committed EDE to a long-term debt promissory note with a 4.53% interest rate and a  
3 "make whole" provision that EDE would pay all the remaining interest payments on the note in  
4 the event the note was retired earlier than its 15 year term period. Thus, making refinancing  
5 difficult if EDE decided to refinance at lower interest rate. It was puzzling at first to discover that  
6 LUSC and LUCo did not examine other long term opportunities such a collateralize bonds of the  
7 same nature as the bonds being redeemed and with lower interest rates. Then I realized that any  
8 effort to reduce the costs of the refinancing, would reduce the amount of profits that LUSC and  
9 LUCo receive from EDE's customers.

10 **Q. Was this LUCo/LUSC refinancing scheme a normal business transaction?**

11 A. No. Independent non-conflicted buyers and sellers would not have engaged in this transaction  
12 when the buyer (EDE) realized that they can obtain the funds cheaper than the prospective seller.  
13 LUCo's refinancing scheme would not occur as a normal business transaction, as the utility would  
14 have no incentive to pay a third party vendor more than the cost the utility incurs to do the  
15 refinancing itself, or the value EDE would pay under its commercial paper option. Unfortunately  
16 this protection is removed in an affiliate transaction where EDE is charged one of the most  
17 expensive refinancing options while LUCo uses the cheaper short term financing.

18 **Q. Did EDE obtain a financial service from an affiliate that did not comply with the rule?**

19 A. Yes. Another aspect of the LUSC/LUCo financing scheme was charging EDE fees for issuing a  
20 hypothetical debt security that was never issued. LUC was the originator of the \$450,000 fee that  
21 LUC charged to LUCo, which, in turn, LUCo charged to EDE as the fee for a financing, that  
22 neither LUCo nor LUC incurred.

1 **Q. What are the non-compliant aspects of this transaction?**

2 A. The transaction was structured in a way where EDE would provide a financial advantage to LUCo.  
3 by not exploring the least cost option.

4 **Q. How did EDE provide a financial advantage to LUCo?**

5 A. First, EDE did not explore refinancing options for itself, such as collateralized notes or make-  
6 whole provisions. Collateralized notes carry a lower interest rate because of the lower risk since  
7 the debt is backed by assets. The “make whole” feature is a condition that the lender (LUCo) would  
8 desire, but EDE would not. Competitive bidding would have allowed EDE the opportunity to  
9 examine these and other conditions before borrowing \$90 million from LUCo. EDE would have  
10 considered these and more options if it were independent from its affiliate ownership.

11 Second, there was no investigation by EDE, or on EDE’s behalf, of the cost and term impacts of  
12 new debt (e.g. 10 year versus 30 years) that it was refinancing. Instead, LUCo dictated the terms  
13 EDE had to accept to refinance its \$90 million first mortgage bonds. Moreover, LUCo, a for-profit  
14 entity, arranged to borrow the money for itself on more favorable terms thereby generating a profit  
15 for LUCo at EDE’s and its customers’ expense. In addition, EDE subsidized LUCo by not  
16 considering the better available options than the LUCo terms and conditions used to raise the \$90  
17 million of funds. In fact, EDE could have raised the \$90 million on better terms than LUCo, since  
18 EDE had access to commercial paper at the time when it was not available to LUCo. However,  
19 that option would not allow LUSC/LUCo to profit from EDE’s \$90 million refinancing.

20 **Q. Does the failure to competitively bid show that EDE provided a financial advantage to**  
21 **LUCo?**

1 A. Yes, EDE did not explore and negotiate for better terms from a third-party lender. The result of  
2 EDE's lack of effort was that there was no documentation proving whether or not these other  
3 options should have been taken. The rule contains documentation requirements to be able to show  
4 compliance with it. 20 CSR 4240-20.015(4)( C) (2) states that EDE is obligated under the rule's  
5 Record Keeping Requirements as follows:

6 "(C) In addition, each regulated electrical corporation shall maintain the following information  
7 regarding affiliate transactions on a calendar year basis:  
8

- 9 1. Records identifying the basis used (e.g., fair market price, FDC, etc.) to record all  
10 affiliate transactions; and
- 11 2. Books of accounts and supporting records in sufficient detail to permit verification of  
12 compliance with this rule."  
13

14 Unfortunately, LUSC's efforts to generate more profit at LUCo to EDE's and its customers'  
15 detriment, necessitated a violation of the rule's standards and documentation requirements. LUSC,  
16 on LUCo's behalf, exercises control over EDE allowing it to consider only the terms demanded  
17 by its affiliate (LUCo) to the exclusion of better terms and conditions available to it elsewhere.  
18 EDE's subsidization is shown by comparing the terms and conditions forced on EDE to borrow  
19 the \$90 million to the actual terms and conditions LUCo incurred to raise the \$90 million in funds.

20 **Q. How did LUCo fund its 15-year promissory note with EDE?**

21 A. LUCo funded the promissory note by borrowing \$90 million from its own line-of-credit using a  
22 form of short-term debt financing. At this time, EDE had less expensive short term debt options,  
23 as EDE had commercial paper capability that was less expensive than LUCo's short debt it used  
24 to finance the refinancing.

25 **Q. What was the interest rate on the promissory note between LUCo and EDE?**

26 A. 4.53%

1 **Q. How does EDE's promissory note interest rate of 4.53% compare with LUCo's line-of-credit-**  
2 **interest rate?**

3 A. It is materially higher.

4 **Q. Is this the only financial advantage EDE provided LUCo on this refinancing?**

5 A. No, EDE gave LUCo two (2) more financial advantages. First, Liberty Utilities (Canada) (LUC)  
6 charged LUCo a \$450,000 fee related to the issuing of the promissory note debt. The debt issuance  
7 charge fee originated from Liberty Utilities (Canada) (LUC) to LUCo. Then LUCo charged EDE  
8 the \$450,000 debt issuance costs for debt that was not issued, but, instead, was raised from  
9 borrowing on LUCo's line-of-credit. In actuality, LUCo charged EDE for issuance costs for long-  
10 term debt that was never issued for the refinancing because the funds were actually borrowed from  
11 the LUCo credit facility.

12 **Q. What other financial advantage did EDE give LUCo when refinancing EDE's \$90 million**  
13 **first mortgage bonds?**

14 A. EDE's \$90 million of first mortgage bonds were exchanged for a loan from LUCo that LUCo  
15 funded through its credit facility when EDE's lowest cost option was EDE's commercial paper.  
16 Since that option was available to EDE, but not to LUCo, LUCo used its control of EDE to prevent  
17 EDE from using its lowest cost option of borrowing \$90 million with its commercial paper. This  
18 refinancing was contrary to the rule, as well as the MoPSC merger/acquisition conditions.

19 **Q. Do you know the financial impact to EDE of the non-compliance created by LUSC on**  
20 **LUCo's behalf?**

21 A. In Case No. AO-2018-0179, I identified the financial impacts of the LUCo/LUSC's refinancing of  
22 EDE's \$90 million first mortgage bonds. I calculated that EDE was incurring and overpaying

1 LUCo \$645,750 in interest costs annually that LUCo was not paying resulting in greater LUCo  
2 profits at EDE's expense. Over the fifteen (15) year term of the promissory note, EDE will pay  
3 over \$9.5 million more interest than LUCo is paying for its credit facility borrowings. In addition,  
4 the number is approximately \$10 million because EDE will also be paying LUCo \$450,000 for a  
5 placement fee never planned to be paid to a third party vender.

6 **Q. Did the Commission examine this problem when it decided the Money Pool case?**

7 A. No. It found these items not to be germane to that case. Certainly these issues are germane to the  
8 present case, where EDE is seeking to recover from its retail customers these fictional costs from  
9 an affiliate transaction/related party promissory note. This is an affiliate abuse that never should  
10 have incurred or been recorded on EDE's books.

11 **Q. Does EDE acquire its affiliate transactions through competitive bidding?**

12 A. No. EDE does not use competitive bidding for their transactions with affiliates.

13 **Q. Can you identify the factors that show that all of EDE's affiliate transactions are not in  
14 compliance with the MoPSC affiliate transaction rules (20 CSR 4240-20.015)?**

15 A. Yes. First, EDE is in violation of the rules requirement that EDE can only participate in affiliate  
16 transactions that are rule compliant with the rule's Standards section (20 CSR 4240-20.015 (2)  
17 (D). Second, EDE is in violation of the rule's "Evidentiary Standard" section requiring the use of  
18 the competitive bidding process when purchasing information, assets, goods, and services from an  
19 affiliate. EDE also can operate without competitive bidding when the Company can show that it  
20 is in the best interest of its customer not to comply with the rule. The correct approach for EDE if  
21 it desires not to follow the rule's competitive bidding requirement is to file for Commission  
22 approval of a "waiver" to not follow a rule requirement after EDE has made a showing of "good

1 cause” that competitive bidding should not be required. However, without such a waiver, the  
2 Company must comply with the rule until the waiver is approved by the Commission.

3 **Q. How does EDE assert it is complying with the MoPSC’s affiliate transactions rules?**

4 A. EDE relies on a CAM(s) that this Commission has not approved. The Company stated in its  
5 responses in AO-2018-0179 to several OPC data requests:

6 **RESPONSE:** The Algonquin Power & Utilities Corp. Cost Allocation Manual is  
7 incorporated by reference into the Affiliate Service Agreements (the “ASAs”). The  
8 Missouri Applicants do not review each potential service in advance, as the affiliate  
9 compliance aspect of such services has already been addressed by the requirements of the  
10 ASAs and the Cost Allocation Manual. The Missouri Applicants are not aware of any  
11 violation of the MoPSC affiliate transaction rules (“Rules”) in connection with this matter  
12 and are not aware of any allegations of noncompliance. In order to more fully respond to  
13 the questions/requests regarding compliance with the Rules, the Missouri Applicants will  
14 need the certain subparts of the Rules which are of concern to OPC and identification of  
15 what actions OPC believes may not have been in compliance with the Rules.”  
16 Response to OPC number 1054C.

17  
18 As I have testified above, utility CAMs are to provide details for complying with the Commission’s  
19 affiliate transactions rules, and they must be Commission approved. These CAMs neither comply  
20 with the Commission’s affiliate transactions rules nor are they Commission approved. EDE’s  
21 complete data request responses are contained in SCHEDULE RES-D-10.

22 **Q. What are ASAs?**

23  
24 A. ASAs stand for Affiliate Service Agreement. The ASA contracts EDE has provided to OPC are  
25 attached as Schedules RES-D-11 through RES-D-14.

26 **Q. Does EDE have contracts with all of its affiliates with whom it transacts?**

27 A. No.

28 **Q. What EDE affiliates do business with the Company under a contract?**

1 A. All of the EDE affiliates executing transactions with the Company under an ASA and using the  
2 APUC CAM have a contract with EDE. These entities are APUC, LUC, LUCo, and LUSC.

3 **Q. What EDE affiliates do business with the Company that is not controlled by a contract?**

4 A. EDE subsidiaries, Empire District Gas (EDG) and Empire District Industries conduct business  
5 with EDE without a contract.

6 **Q. Are there any other affiliates that do business with EDE without a contract?**

7 A. Yes. Transactions between charging affiliates (e.g. LUC charging LUCo) are not done under  
8 contract, but are included in costs that EDE is charged for goods and services. For example, LUC  
9 charged LUCo \$450,000 for debt issuance fees that were then charged to EDE. There is no contract  
10 between LUC and LUCo regarding the provision of LUC services to LUCo.

11 **Q. Is the additional affiliate work performed without a contract, identified in the Company's  
12 affiliate transaction report filed annually with the MoPSC?**

13 A. No. In fact, EDE's second tier owner, LUCo, has no employees and is operated by the same entity  
14 that operates EDE, which is LUSC. While LUSC operates LUCo and EDE, an affiliate service  
15 agreement only exists for LUCo to charge EDE. When LUCo transacts with LUSC or LUC, no  
16 agreement exists even though these costs will be ultimately charged to EDE.

17 **Q. Do EDE's affiliate transactions have any negative impact on its ability to provide its Missouri  
18 electric retail customers with safe and adequate service at just and reasonable rates?**

19 A. Yes. First, adequate service is not being provided when EDE through LUSC, LUC, and APUC  
20 offers contracts to these affiliates that are not offered to other persons or companies. Second, it is  
21 not just and reasonable to pay the costs of goods and services supplied by an affiliate and then be  
22 responsible for all the other costs of the affiliate.

1 Third, the Algonquin CAM utilized by EDE does not use the accounting and costing system that  
2 is required by the rule. The rule requires a costs and accounting systems designed to be based on  
3 goods and services produced and provided. The Algonquin CAM is based on allocation to  
4 Algonquin entities not related to the goods and services produced and provided. The Algonquin  
5 CAM is based on assigning cost factors such as Revenues, Operation & Maintenance expense, Net  
6 Plant, Customers, Non-labor and labor expenses. Thus, under this cost assignment method, EDE  
7 will be charged a significant amount of affiliates costs whether EDE consumes little to none of the  
8 goods and services produced by these affiliates. EDE can reduce its consumption of an affiliate  
9 product and see no reduction in costs as EDE would experience in dealing with independent sellers.  
10 The rule is premised on the principle that the entity causing the cost should pay the cost. Thus, the  
11 rule's cost distribution process is based on the principle that the buyer only incurs costs when it is  
12 receiving needed or net beneficial goods and services, not because the buyer became an affiliate  
13 to new entities.

14 **Q. What is OPC's position regarding affiliate transactions in this case?**

15 A. This rate case is an example of what happened in Commission rate cases before the rules were  
16 promulgated. Companies submitted questionable and unproven costs for recovery with little or no  
17 supporting documentation to show that the transaction(s) was legitimate and prudent. That is what  
18 happened in this case. It is EDE's responsibility to show that its purchases of goods and services  
19 from affiliates is consistent with this Commission's affiliate transactions rules or that it has  
20 obtained a waiver from the Commission that the transactions are in its customer's best interest. It  
21 is also EDE's responsibility under the rule to engage in affiliate transactions that reflect the cost  
22 of an arm's-length transaction. At this time, EDE has not complied with the rule and should have

1 none of these costs on its books and records. EDE acknowledged these rule requirements and  
2 commitments to the Commission in order for it to be acquired by Algonquin. My estimate of the  
3 value of this issue is approximately \$100 million. This is not the total revenue requirement at this  
4 time because some of these costs would be capitalized. On the other hand, some of the existing  
5 rate base plant would have an element of inappropriate affiliate transactions from prior periods.  
6 .EDE's Affiliate Transaction Report lacks the required detail to report affiliate transactions by  
7 amount and account charged making it difficult to exactly quantify the issues exact value at this  
8 time.

9 **Q. Does this conclude your direct testimony?**

10 **A. Yes.**